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SUBJECT: PARIS CLUB - MAY 2006 TOUR D'HORIZON AND DEBT NEGOTIATIONS

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SUMMARY  
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11. (U) At the May 10-12 meeting of the Paris Club, Afghanistan's three creditors, Russia, Germany and the United States, took the first step toward fulfilling their pledges to cancel 100% of Afghanistan's debt by providing assurances of debt relief during the period of Afghanistan's new IMF program, which is expected to be approved in early June. Creditors rescheduled the debt of Moldova

and Grenada on non-concessional terms, and formally accepted Algeria's offer to prepay at face value its previously rescheduled Paris Club debt. The U.S. will partially participate in the prepayment by accepting \$665 million owed by Algeria to Eximbank. Creditors welcomed Angola's offer to pay the Club \$2.7 billion over the next two years (out of \$4.5 billion owed), but rejected Angola's request to negotiate the balance (\$1.8 billion) on a bilateral basis. Paris Club Chairman Musca will continue to press the Angolan authorities to seek a multilateral solution to normalizing relations with Paris Club creditors. Other countries on the agenda included Argentina, Brazil, Cameroon, DRC, Iraq, Kyrgyz Republic, Nigeria, Russia, Serbia Montenegro, and Sierra Leone. END SUMMARY.

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Afghanistan

¶2. (SBU) Germany, Russia, and US provided financing assurances for Afghanistan's Poverty Reduction and Growth Facility (PRGF) with the IMF. Russia said \$8.4 billion of the \$9.4 billion in debt owed by Afghanistan was reconciled two years ago, and that meetings are scheduled in Kabul in coming weeks to reconcile the remaining \$1 billion. The US pointed out that full reconciliation was not necessary at this stage, but would have to take place before Afghanistan received a Naples treatment on its debt. The IMF added that full reconciliation was necessary for Afghanistan to be declared eligible for the Heavily Indebted Poor Countries (HIPC) initiative. In response to a question from Germany, the Secretariat said it was not opposed in principle to capitalizing interest payments during the period of the PRGF (this would be done so that Afghanistan will not have to make any payments during that time), but that any decision should be based on Afghanistan's capacity to

pay. The Secretariat will launch a data call in preparation for Afghanistan's Naples treatment, likely to occur in July.

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Algeria

¶3. (SBU) Creditors signed an agreement formally accepting Algeria's offer to prepay at face value its previously rescheduled Paris Club debt, which totals \$7.7 billion. The prepayment transactions will take place between May 31, 2006 and November 30, 2006, at a date determined bilaterally between Algeria and participating creditors. Nearly all creditors committed to participate either in full or in part, notwithstanding some arrears. Russia, having recently concluded a separate debt restructuring agreement with Algeria, was an observer to the agreement. The US reiterated that only debt owed to EXIM (around \$665 million) can be prepaid at face value. Germany pressed for a buyback option, but France insisted that creditors had already agreed in principle last month to prepayment at face value.

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Angola

¶4. (SBU) Paris Club Chairman Musca reported on his April meeting with Angolan Minister of Finance de Moraes. In response to the Club's proposal that Angola resume debt service in excess of maturities falling due, Angola offered to pay \$2.7 billion over the next 12 to 24 months, an amount intended to cover outstanding principal (\$0.4 billion) and arrears (\$2.3 billion) but not late interest (\$1.8 billion). As a condition for this payment, Angola would reserve the right to negotiate with creditors bilaterally on the \$1.8 billion residual, presumably in the expectation of securing favorable restructuring terms. Creditors agreed that this part of Angola's counteroffer was unacceptable, but authorized Musca to continue contacts with the Angolan authorities on a multilateral approach to arrears clearance. Musca will also indicate that creditors would consider a more favorable debt treatment if Angola concludes an IMF program, and that a resumption of payments by Angola could lead some creditors to reopen credit lines. Musca is scheduled to meet with the Finance Minister at the end of May.

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Argentina

¶5. (SBU) Creditors reacted to reports that Argentina may be

interested in addressing its Paris Club debt in the second half of 2006. Germany, Italy, the Netherlands, and the UK stressed that the Club needed to act in unison and encourage the authorities to pursue a multilateral solution. Germany urged the Secretariat to contact the authorities immediately. In response, the Secretariat said it had already requested a meeting with Argentina on the margins of the IMF-World Bank spring meetings, only to be turned down. In the end, creditors agreed that the ball was in Argentina's court.

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Brazil

16. (U) Although Brazil has concluded its Paris Club prepayment operation, arrears remain to Canada, Germany, Italy, and the Netherlands. The Secretariat sent a letter to the authorities urging them to clear these arrears by June 30, 2006. There was no discussion of a reported Brazilian request to become a full member of the Club.

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Cameroon

17. (U) The Secretariat confirmed that Cameroon will come to the Paris Club next month to negotiate the terms of its HIPC completion point treatment.

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Democratic Republic of the Congo

18. (SBU) The DRC is no longer on a PRGF or other type of IMF program that would qualify it for HIPC interim debt relief. Germany, supported by Belgium, proposed that creditors nonetheless extend HIPC interim relief on the basis of a Staff Monitored Program (SMP) that the IMF is discussing with the DRC. The US explained that it had a legal obligation to resume billing now that the DRC no longer has a PRGF in place. The Secretariat said extending interim relief on the basis of an SMP would set a bad precedent. However, in light of the DRC's limited payment capacity, the Secretariat suggested that creditors who are able to do so not send bills for the next interest payment.

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Grenada

19. (U) Creditors (Belgium, France, Russia, the UK and the US)) agreed to reschedule Grenada's 2006-2008 debt service, in support of the country's PRGF. Medium and long-term debt was rescheduled over 12 years, with a 5-year grace period (so-called classic terms), while Belgium and the UK's short-term debt will be repaid over the period 2009-2013.

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Iraq

10. (U) Australia announced that it would sign its bilateral with Iraq on May 11. Russia, on the other hand, reported no progress since last month's discussion. Although Russia and Iraq have agreed on the text of a bilateral, the data reconciliation process remains incomplete. Russia said it was nevertheless hopeful that an agreement could be reached within the next two months.

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Kyrgyz Republic

11. (U) The IMF said the Kyrgyz Republic has begun the HIPC process. Staff is working on a preliminary HIPC document, which is likely to be presented to the IMF Executive Board this summer. Decision Point could be reached in late 2006 or early 2007. There were no comments from creditors. The IMF noted that Haiti is another country that may soon enter the HIPC process.

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Moldova

12. (SBU) Creditors (Germany, Italy, Japan, Russia, and the US) agreed to reschedule Moldova's debt on so-called Houston terms, in support of the country's PRGF. Development assistance debt was rescheduled over 20 years, with a 10-year principal grace period,

while commercial debt was rescheduled over 15 years, with a 5-year grace period. Moldova agreed to pay 70% of its Paris Club arrears over the next three years, with the balance rescheduled on Houston terms together with maturities falling due between May 1, 2006 and December 31, 2008. Russia took the hardest line during the negotiations, initially arguing for a rescheduling over a shorter time horizon and with a shorter grace period.

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Nigeria

113. (U) All creditors except Austria, Brazil, and Denmark have received their final payment from Nigeria. Brazil and Denmark reported that their bilateral agreements had yet to enter into force. Austria said it expected to close its deal with Nigeria early next year.

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Russia

114. (SBU) Russia will come to the club in June to negotiate the terms of its offer to prepay all of its remaining Paris Club debt at face value. A majority of creditors signaled their intention to participate, although several creditors holding a substantial portion of Russia's Paris Club debt indicated they would only participate if the prepayment included an option to buy back the debt at more than face value. In particular, Germany said its securitized Aries debt could not be prepaid at face value. Russia advised the U.S. delegation privately that it would not pay more than face value.

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Serbia Montenegro

115. (SBU) The IMF and Secretariat briefed creditors on the potential implications of an independent Kosovo, noting that if Kosovo were allocated a significant portion of Serbia's debt, it would not likely be in a position to service it, and therefore some type debt relief would probably be necessary. The US and Russia said it was important to monitor the debt allocation process to ensure that it was fair and to avoid creating perverse incentives for Serbia to unload debt on Kosovo. The World Bank cautioned that it would be very difficult to restructure World Bank debt.

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Sierra Leone

116. (U) The IMF said approval of the Sierra Leone's new PRGF could lead to HIPC completion point by the end of the year. The Secretariat said it would draft a letter to the authorities

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announcing the extension of interim HIPC relief.

STAPLETON#